Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE revival of the war debts question in a controversial and disturbing manner, at a time when the cooperation of all governments and peoples is urgently needed to strengthen business confidence and carry forward the improvement which began last Summer, has added to the confusion of the economic situation. The markets have viewed the possibility of a premature resumption of the war debt payments with apprehension, and sterling exchange, which would naturally prove most sensitive to these apprehensions, has been acutely weak, falling to $3.15 or 3 cents below the previous historic low of $3.18 reached just after the war.

The approach of December 15, when payments on the debts are due to be resumed, has made the subject one of utmost urgency, but the foreign governments concerned have refrained from approaching the American Government on the question of further postponement or revision until after the elections in this country when the question presumably could be considered upon its economic merits, free of campaign atmosphere. Now that the elections are over the foreign governments have submitted notes to this Government asking for a re-examination of the debts in the light of the new economic conditions, and for a continuance of the moratorium in the meantime.

The reason for these applications is the decline of world prices and trade, which makes the transfer of the debt payments vastly more difficult and disturbing. Moreover, the appeal of the debtors naturally follows the conference at Lausanne in July, where in attempting to settle the reparations question permanently the foreign governments were compelled to choose between no settlement at all and one conditioned upon subsequent negotiations with the United States. They chose the latter course, and unquestionably it is in the interest of the United States, as of all the other countries in the world, that the fruits of the Lausanne Conference should be preserved.

The fact that the debts question was nearing a critical stage with the approach of December has, of course, been known all along, but it had been assumed that the problem would be dealt with in a spirit of mutual toleration and with a broad understanding of the common interest in preserving the already weakened fabric of international credit and exchange from further dangerous shocks. For this reason it had been expected that the application of the foreign debtors for a review of the debts would receive from this country a considerate hearing, and this is the attitude taken by both the President and the President-elect. Mr. Hoover has called it "unthinkable"—

> that our people should refuse to consider the request of a friendly people to discuss an important question in which they and we both have a vital interest . . . This is particularly true in a world greatly afflicted, where cooperation and good will are essential to the welfare of all.

And Mr. Roosevelt has stated his belief that the debtor—

> should at all times have access to the creditor . . . This is a rule essential to the preservation of the ordinary relationships of life. It is a basic obligation of civilization. It applies to nations as well as individuals.

Where the Emphasis Belongs

These expressions are entirely appropriate taken by themselves, but may tend to confirm the idea already prevalent among our people that the main purpose of a conference would be to hear representations of the debtor governments about the depression existing in their respective countries and the hardships which the debt payments will impose upon their peoples under present conditions. The opposition to postponement and review is based upon this very assumption, the reaction being that the same conditions exist in this country and that there is no reason why the burdens of our own people should be increased in order that the burdens of the debtors should be lightened. Emphasis is laid upon the great body of domestic indebtedness in default, and Congressmen say that it is impossible for them to release foreign debtors from their obligations to make payments which are needed to give some relief to our debtor classes.

179

This view of the proposals is a mistaken one. The true purpose is to consider the part that international debt payments have played in the breakdown of world trade and the influence they will have, if continued, to prolong the depression. The people of the United States, with their great volume of exports, are as much interested in this as any people. The prices of our export commodities, of which wheat and cotton, are outstanding examples, are of vital importance to our own debtor class.

Before the war, with the United States and Europe both on a gold basis, the currencies of these countries had practically fixed relations to each other, there was a common basis of prices and payments were as easily made between countries as within countries. This is the service of the common standard of value. But the maintenance of a common standard of value requires that trade and international payments of all kinds shall be in approximately balanced relations not requiring gold shipments so large as to deplete bank reserves and disturb credit conditions. The basic principle of the common gold standard is that of maintaining stable relations in trade, in finance, and in prices throughout the world.

During the war the gold standard was generally abandoned temporarily. Our immense exports were settled partly in gold and partly by the government loans that are now the subject of discussion. After the war was over and the countries returned to the gold basis our favorable trade balances were largely settled for a number of years by private loans, but when we ceased to lend and the credit situation became generally unsettled the heavy demands for gold in the exchanges forced more than one-half of the nations, Great Britain among them, off the gold basis. Thus the monetary relations have been disrupted, and the common basis of trade and prices has been lost. The results upon industry, trade, employment and prices have been disastrous. All nations are resorting to extraordinary measures to reduce their imports, and all are injured by each other's efforts. It is of the utmost importance that cooperative action be had to stabilize the various currencies in their relations to each other, and this is to be the chief problem before the international conference to be held.

The British currency now has no fixed relation to the United States money, but the British Government is endeavoring to give it a degree of stability in relation to the present price level. The British debt of $95,550,000 due on the 15th instant can be paid in gold, but the United States already is firmly on the gold basis, with all the reserves it needs. It is more important to this country that other currencies, and particularly British currency, shall be stabilized than that we should increase our gold stocks. It is in the common interest that Britain shall not reduce her gold reserve, for that will tend to make her currency more unstable.

If Britain is not to pay by shipments of gold she must go into the markets and bid for the means of payment in the United States, in other words for dollar exchange. On account of the low state of international trade and the falling off of exports to this country the amount of dollar exchange (claims on the United States) is abnormally small, and the demand for it will raise the price, not only in London but in all markets. Thus it will be made more difficult and costly to obtain the means of making payments in the United States, manifestly to our disadvantage. In other words, by forcing the issue at this time we make it more difficult to sell our products not only to Great Britain, but everywhere. More currencies are now related to British currency than to the gold standard, and the effect of widening the gap between the pound sterling and the dollar must be to depress the general price level in all of these countries in comparison with our own price level, and since prices upon our export commodities abroad affect our own domestic prices, the final effect of depressing these currencies is to drag all commodity prices to a lower level. Above everything else this should be averted.

It is true that as an alternative to either shipping gold or buying exchange the British Government might temporarily borrow in the United States. But obviously this would be no permanent solution of the difficulty.

To sum up, the most pressing problem now is to do something constructive to stabilize currencies, improve world trade conditions, and maintain such foreign demand as there is for our products, and meantime nothing should be done to make the situation worse.

Effects on Commodity Prices

The markets have given prompt evidence of the depressing effects of the decline in sterling upon prices. About the first of the month the fall in commodity prices which had been under way since early September appeared to come to a halt, with indications of greater firmness in many of the important staples including wheat, cotton, hogs and the non-ferrous metals. However, the improvement was quickly checked. The trend of the major commodities since the middle of the month has been downward. New lows have been made by wheat, cattle, silver and cocoa; and others which have dropped back to the lowest levels since early Summer include cotton, silk, wool, rubber, sugar and tin. The gains of the feed grains and hogs proved brief ones. This softening of prices is plainly associated with the exchange disturbance and the unsettlement of confidence,

and illustrates what has been said as to the effects of the situation.

There is a factor bullish on farm prices which in the circumstances has received virtually no attention. It has been believed for some time that Russia would not be exporting to the world markets in disturbing quantities next year, and now this is made certain by the admission of the Soviet Government that a serious food shortage exists. The Moscow correspondent of the New York Times describes the situation in the following terms:

> Two-thirds of the Soviet population will be lucky if it gets more than bread, potatoes and cabbage this Winter as a regular diet, with fish three times a week, say, and meat perhaps once a week. And that in quantities below the people's wants and probably below their needs. There is no famine or actual starvation, nor is there likely to be. And, for the most part, all will share alike in the various localities, but it is a gloomy picture, and as far as the writer can see, there is small sign or hope of improvement in the near future.

The Department of Agriculture has had reports from Russia of delay in sowing the Winter crops beyond the favorable season, and of failure to plant the prescribed acreage. The national livestock supply is said in the Times articles to be 40 or at most 50 per cent of five years ago, with stabling and fodder for the Winter only half provided, and draft animals already undernourished, with consequent effect on agriculture. A third of the tractors are reported unusable. These reports indicate that if the present heavy stocks of wheat, due in part to Russian exports which never should have been, are once cleared away, the grain markets will regain a normal status.

Except for these developments in the markets, the trade news has shown no pronounced change during November. As usual, industrial activity has fallen somewhat below that of October, which is always the busiest month of the Autumn. But there had been little expectation that the "Fall rise" would continue past the usual peak, in view of the unemployment and low state of farm purchasing power and the disturbing fiscal, debt and trade problems. The important thing is that a forceful demonstration of recuperative power has been witnessed. It has brought business out of the bottom of the trough.

The result of the elections gives to the Democratic party after March 4 undivided power and responsibility, and of course the leadership of the party in the Congress now about to meet for the short session is likewise strengthened. It would be unfortunate if the new administration at its beginning should be embarrassed by unsound fiscal or monetary proposals coming from its supporters, and with the harmony which naturally exists in a newly successful party it may be expected that inclinations of that kind on the Democratic side will be restrained. Likewise, the Republicans in both Houses owe respect to the declarations of their latest party platform and to the principles upon which President Hoover has stood before and since the election. Both parties are distinctly pledged to sound policies regarding the currency and national finance, and in both the leaders of chief influence recognize that there can be no early recovery unless confidence is maintained upon these subjects.

Individuals Responsible for Prosperity

No question is of greater importance to the country at this stage of the depression than that of the government's relation to business, and what government policies can best promote business recovery. The emphasis of the campaign speeches has been upon what the government has done or has left undone, and undoubtedly the effect has been to make many believe that governments are primarily responsible for prosperity.

It is regrettable that this has been the case. The fact is that the relations of governments to prosperity are negative rather than positive. A bad government, which wastes the public revenues, needlessly burdens the people with taxation, fails in the provision of a sound monetary system or in the maintenance of order or the proper administration of justice, will hamper the prosperity of the people, disturb business, and block or retard recovery; but for the most part industry, trade, and business of all kinds are carried on by the people without other governmental assistance. The relations involved are those of persons or groups to other persons or groups, and are determined by themselves.

All students of the question recognize that the fundamental condition of prosperity is a state of balance in various economic relationships between individuals or groups of the population. It is necessary that costs, prices and wages of every kind be in equitable relation with other costs, prices and wages, so that the goods or services offered by each group exchange on an equitable basis with those offered by others, resulting in a rapid flow of all products into consumption. Goods coming to the market not only satisfy needs but represent buying power for other goods, and there is no source of buying power outside of the exchanges between the various industries and occupations. Full employment, ready sale of goods and a high state of comfort are all dependent upon these exchanges, and hence upon the maintenance of balanced relationships.

In the state of free society which exists in this country the government can have little to do with these relationships. The people themselves determine them. In these relationships is to be found the explanation of the in-

dustrial disorder of today; and obviously the remedy is to be found there and must be applied by the individuals involved.

Limits of Government Activity

Nor does the fallacy of attributing to the government the responsibility for prosperity end there. When business falls off the government not only lacks power to restore the basis of exchange that would revive it, but it can not possibly carry on sufficient activities of its own to make up for the decline, to compensate for the loss of purchasing power on the farms, or to give employment to any important number of the unemployed released from industry. The government has no revenue or buying power other than that derived from the production and profits of business, out of which the people pay taxes and subscribe to government loans; and when there is a rapid decline of business, government expenditures can not continue indefinitely without bringing the government credit under question.

These considerations indicate both that reliance upon positive action by the government for the restoration of prosperity will lead to disappointment, and that danger attends the effort to place the responsibility on the government; and evidently this is the truth of the matter. Those who count upon some stroke of administrative policy are not likely to make as vigorous efforts to get their own affairs in order, or to give as freely their co-operation in restoring the balance in costs, wages and prices, as if they realized to the full their own responsibilities, and the attack upon the problem of readjustment is thereby weakened. Moreover, and of course equally grave in its consequences, is the danger when governmental expenditures, made out of borrowings, are pushed too far and arouse apprehensions as to the national credit. The country is not free from concern upon that score.

Of all possible consequences of this fallacious ascription of economic power to the government, the most serious would be tinkering with the monetary standard, and there has been disturbance, happily unwarranted, on that ground also. Undoubtedly this is a method by which the government could greatly alter economic relationships, but not with the result of bringing them into balance. On the contrary, changes in the monetary standard would introduce a new element of disorder and throw all relationships into greater chaos, a fact illustrated in the flight of capital out of productive uses which has taken place in countries whose money has depreciated, or where the depreciation of the money has even been suggested. It may be considered that this is the end which is reached when people evade or deny their problems, refuse to co-operate and readjust their relationships, and mistakenly throw all the burdens on the government and eventually on the monetary system.

The Question of the Deficit

In the present situation the government is following a reasonable policy of supporting key institutions, and it can do little more of a positive nature. But it can protect business from further political shocks, and remove obstacles to recovery which come within the sphere of governmental action. The war debts problem is one such obstacle, and the deficit which the United States Treasury is running is another. The deficit is viewed by some with little concern. However, the only ground for complacence respecting it is that both parties are pledged to balance the budget before the fiscal year 1933-34 begins. If there should be any abatement of resolution to carry out this pledge, or other cause for anxiety over the budget, the shock to business undoubtedly would be severe; while on the other hand the prompt enforcement of economies and imposition of taxes necessary to close the gap will promote confidence and free business of a major uncertainty.

Evidently there are persons who in all sincerity are puzzled as to why it is necessary to balance the budget even at the cost of increasing taxes in a time of depression. They see on all sides the results of a lack of buying power and they easily arrive at the view that the Treasury's expenditures in excess of receipts constitute a disbursement of buying power which they conclude should be enlarged rather than curtailed.

The fallacies of this conclusion have already been touched upon. Government expenditures do not remove the causes of the depression, nor can they be continued indefinitely. Of course there are only two ways in which a government can cover its deficit, by printing money or by borrowing. The former constitutes debasement of the currency, and fortunately its dangers are understood even by those who would like to experiment with it, for they always argue that this country would be an exception and would keep the printing press under control. However, monetary history is not reassuring upon this point. It is a well-established principle of monetary science that currency issues should be under the control of the central bank and should not be made by a political body, for if one Congress can work its will on the currency so can the next and the next. Once this course is embarked upon, there may be no end, no stability in the monetary factors which are the basis of all trade relations and contracts, no order or confidence.

On the other hand, if the deficit is met by borrowing, there are plainly limits beyond

which the borrowing can not go without such disturbing effects as to offset, and perhaps more than offset, the temporary stimulus of the disbursements. Even the bonds of the United States can not be offered in ever increasing amounts without disturbing the market for all bonds, causing concern as to market prices, and inhibiting new flotations of corporate issues; or without making capital timid and causing it at best to seek absolutely riskless employment, and at worst to flee into hiding or out of the country. It is evident to all observers that there are now serious apprehensions upon these grounds which only a rigid balance of the budget will relieve.

Moreover, it must be considered that the entire program of breaking the vicious circle of deflation by giving the support of the public credit to private credit-granting institutions is in jeopardy unless the budget is balanced. This program has made a good beginning and favorable progress, but its success depends upon continuing growth of confidence in order that the credit system may be free of further strain and greater use made of the resources of credit and private capital to promote business revival. It is self-evident that the public credit can not successfully hold the breach against deflation if it is used so extravagantly as to frighten private capital out of use. The budget is the heart of the problem.

The Treasury's Borrowings

The Treasury has operated at a deficit since June, 1930, and in that period of two and one-half years has borrowed over 4½ billion dollars of which the bulk has been provided by the banks. The following table gives the total interest bearing debt as of June 30, 1930, and an estimate for November 16, 1932, with figures of the holdings of United States securities by banks and other investors:

(Millions of dollars)

	June 30, 1930	Nov. 16 1932	Increase
U. S. national debt, gross	16,185	20,841	4,656
U. S. Securities held by			
Federal Reserve banks	578	1,851	1,273
Reporting member banks	2,877	5,309	2,432
All member banks	4,061	6,750*	2,689
All other banks and investors	11,546	12,240*	694

* Estimated.

The holdings of government securities by the reporting member banks now represent 28 per cent of their total loans and investments, and if the New York City banks be considered separately, their holdings represent 37 per cent of their loans and investments. If member bank holdings could be broken down it would doubtless be found that more than half consists of bills, notes and certificates maturing in less than five years, of which there are more than six billions outstanding, or 30 per cent of the total debt.

Of course, there is at some point a limit to the readiness of banks to carry a constantly enlarging portion of their assets in government securities. Also, an operation to fund part of the short-term debt into long-term obligations is recognized as inevitable. These are the uncertainties of the situation which are affecting the bond and money markets and the will to invest generally. They afford one of the explanations of the lack of a long term market for corporate bond issues, and of the paradoxical existence of super-abundant credit and abundant liquid capital side by side with complaints from borrowers that they can not borrow, and from lenders that they can not lend. The way to free the capital market from the restraint of these uncertainties is to balance the budget, thus to halt the Treasury demands and build confidence in bond prices.

Capital Is Needed

It is often stated that private industry will not employ credit or new capital, and that the government must employ it to relieve the situation; but while the fiscal uncertainties exist there is hardly a fair test of private enterprise. Without doubt, business improvement would move rapidly if it could be extended to the heavy industries making "capital goods," buildings, machinery and other facilities for raising the standard of life. It is said that the country is over-equipped and that capital investment is not needed, but at best this is no more than a half-truth, in view of the wear and tear of the past three years, the scrapping of plant and machinery, and above all the amounting obsolescence of the equipment in place. The depression has brought forth new methods, new products, and new machinery, and industry needs to re-equip itself to meet changing conditions and to keep costs down. Even in the old industries new capital could be used in vast amounts with benefits in reducing costs and prices. The magazine Coal Age recently stated that at least $375,000,000 could be profitably invested in the coal-mining industry to reduce costs and improve quality. Without doubt similar statements can truthfully be made as to the textile industries and others, illustrating that the barrier is not on the demand side, but the lack of confidence on both sides.

The problem of balancing the budget is not difficult of solution when the will to balance it exists. The ordinary deficit in the current fiscal year to November 21 was $730,000,000, and in addition advances to the Reconstruction Finance Corporation were $391,000,000, a total of $1,121,000,000. However, this is not a fair indication of the showing for the full year. Time was required for the collections from

the new excise taxes to reach a normal, for whereas in July they were only 3 per cent of the estimated monthly average they were 70 per cent in October, and their yield hereafter will be greater. Higher income tax rates become effective January 1. Finally any business improvement will produce higher tax yields, and likewise reduce demands on the R. F. C. A considerable reduction in these demands from the banks and other credit institutions has occurred in recent months, and in that respect the R. F. C. appropriations are already approaching the status of a revolving fund. Loans for self-liquidating projects thus far have been in moderation.

But there is no basis for easy optimism. The country can not afford any abatement of resolution to balance the budget, and in the greatest possible degree through reduction of spendings. The White House proposals for a net reduction of $550,000,000 in appropriations for next year unquestionably have the support of the country. It must be considered that the lack of balance is not only between receipts and expenditures, but between taxation, which is greater than formerly, and the national income which is far less. In this as elsewhere in the economic system the balance needs to be restored.

Money and Banking

Conditions in the money market have changed very little during the past month. Banks in the larger financial centers continue to have more funds than they know what to do with. On November 23, the weekly reporting member banks in leading cities held $500,000,000 of reserves in excess of legal requirements, of which $285,000,000 was held by banks in New York City and $153,000,000 by banks in Chicago. These figures represent a new high level of surplus funds for the period.

The surplus of funds in the cities is, of course, a reflection, on the one hand of the existing unsatisfactory state of business, which makes it difficult for banks to find safe employment for their funds, and on the other of a variety of factors, including (1) a concentration of funds from the country, (2) the easy money policy of the Federal Reserve Banks as expressed in their large holdings of Government securities, (3) the imports of gold, (4) some return to the banks of currency previously in circulation, and (5) the issuance of new national bank currency under the provisions of legislation adopted by the last session of Congress.

To be sure, the Reserve Banks have not recently been purchasers of Government securities. Their purchases were made last Spring with the object of injecting additional Federal Reserve credit into the market at a time when bank reserves were being seriously depleted by gold exports and by the hoarding of currency then in progress. But since the Reserve Banks have not yet seen fit to reduce their large holdings of Government securities now that the gold and currency movements have been reversed, these holdings are still a factor in the situation.

With the Reserve Banks sitting tight on their Government portfolio, the gains to the money market on other accounts have been translated promptly into increased bank reserves. Gold imports and release of gold held under foreign earmark have added $420,000,000 to our monetary gold stocks since June. The demand for currency, while larger than in June, has been decreasing steadily since the July peak. At the same time, the issuance of approximately $138,000,000 of new national bank notes, when no additional currency was needed by the country, has likewise added to the volume of idle funds by driving a corresponding amount of other types of currency back into the banks.

Some part of all this available credit was used by member banks in some sections to reduce indebtedness to the Federal, but the greater part went to increase cash reserves. On November 23, the Federal Reserve statement showed that member bank reserve balances had gained approximately $400,000,000 since mid-Summer, and were back to where they were before the crisis that followed Great Britain's departure from a gold basis.

The Problem of Employing Bank Funds

The inability of the banks to increase their loans and deposits correspondingly has been due to the scarcity of suitable outlets for bank funds under the present conditions of depression and uncertainty. Applications for credit by individuals and corporations who can show some promise of being able to meet their obligations at maturity are few and far between. As a rule, such persons and businesses are not wanting money at the present time. There is a keen enough demand from borrowers who are in difficulties of one sort or another, and need money to replace lost capital, but very little of this represents suitable business for a bank whose first obligation lies in safeguarding the funds of its depositors.

The failure of banks to expand their loans more rapidly has led to some criticism of bank lending policies. This is inevitable in times like these. Much of it is ill-informed and takes no account of the drastically reduced lending power of banks in many localities on account of losses of deposits and slow or doubtful assets. Unfortunately, the surplus funds referred to above are not distributed evenly

throughout the country. Some of this criticism, however, is the result of a doctrine which has found some support in high quarters and is to the effect that the banker's primary responsibility is not to the depositor but to the borrower. It is said that instead of thinking first of the liquidity and strength of his institution, he ought to lend money with less scrupulous regard to the quality of the loans and with more thought of getting credit into circulation so as to stimulate business revival.

Now, it is probably true that some bankers have been over-cautious in their lending policies. Certainly, the record of bank failures over the past year and the readiness of the public to take fright and crowd into the banks with demands for cash have given the banker plenty of reason for wanting to keep his cash drawer full against possible emergencies. Urging the bankers, however, to make loans they do not regard as sound would seem to be poor public policy. There is no doubt but that a condition where money is plentiful and seeking employment is one which, other factors permitting, is favorable to business enterprise. But making money available for business should not involve having the banks take on a lot of questionable paper. The fact that banks may have extended credit more lavishly in the past is no argument for the continuation of that policy now. Everyone knows it would have been better for all concerned if the banks had been a great deal stricter than they were.

Theoretically, the banks can always employ their surplus funds in the bond market, but practically there are limitations to this. Already the figures of the weekly reporting member banks show investments equal to approximately 45 per cent of total loans and investments. A good many of the banks have about all the investment securities they want to carry, having in mind both the immediate hazards to the bond market created by the heavy Federal deficit and the more distant prospects of an increased demand for commercial loans as business revives. While short-term Treasury securities continue to enjoy a preferred market with the banks it is obvious that these alone cannot be expected to absorb the total amount of idle bank credit available.

A Measure of Deflation

The magnitude of deflation involving the country over the past year is shown vividly by the statistics of all banks as of June 30 this year, made public during the past month. The following table gives the figures of this date for loans and investments and for deposits compared with corresponding figures for previous years.

All Banks in the United States
(In Billion Dollars)

June 30	Loans	Investments	Loans & Investments	Deposits*
1928	39.5	17.8	57.3	53.4
1929	41.5	17.0	58.5	53.9
1930	40.6	17.5	58.1	54.9
1931	35.4	19.6	55.0	51.8
1932	27.8	18.2	46.0	42.0

* Exclusive of interbank deposits.

It will be seen that in the year ended June 30, 1932, the shrinkage of bank credit reached the extraordinary total of 9 to 10 billions of dollars, depending on whether the measure is by loans and investments or by deposits. Total loans and investments fell from around 55 billions to around 46 billions, while deposits dropped from approximately 51.8 billions to 42 billions.

This is the toll taken by financial panic. The draining of bank reserves by the gold withdrawals of frightened foreigners and by the currency withdrawals of frightened domestic depositors, set in motion a cycle of forced liquidation which is without precedent in the seventy years of our banking history since the Civil War. It is no wonder that banks failed on all sides, and that the security and commodity markets collapsed under the weight of this overpowering deflation.

Not the gold standard, or a shortage of currency to meet the normal demands of business, or the nefarious machinations of wicked speculators have produced this debacle of the credit system. The cause was a mass movement induced by fear, which crippled the lending power of banks and other credit agencies and threatened to bring the price and credit structure down in total collapse.

During the first two years of the depression the decline of bank credit had been of moderate character, total loans and investments falling by only 3½ billions between June 29, 1929, and June 30, 1931, and deposits by only 2 billions. There was, indeed, a large decline of loans during this period, but as this was accompanied by a substantial increase in the volume of bank investments in securities the decline of total bank credit was not of crushing proportions. During the past year, however, investments too were liquidated under the force of the panic, with the results that have been described.

One of the interesting features of the table is the marked increase in the proportion of banking funds invested in securities as distinguished from loans to customers. We have referred to this before in connection with the weekly reporting banks. The figures for all banks for June this year show security investments to an aggregate of 40 per cent of all loans and investments and 43 per cent of deposits, compared with 29 and 32 per cent respectively on June 29, 1929.

The table at the foot of the page gives in further detail for member banks the changes that have taken place in the various classifications of loans and investments during the past three years. Attention is called to the continuous and heavy decline of loans "otherwise secured and unsecured", which presumably reflect commercial borrowing; likewise to the even greater deflation of loans to brokers at New York, which are among the most liquid and readily realizable of banking assets. Only as the pressure became more severe during the past year was there any important reduction in the general run of loans secured by stocks and bonds. Loans to banks continued down into mid-year to reflect a condition of credit strain, while loans secured by real estate, proved, as might be expected, to be the most inflexible of all. It is shown that the liquidation of investments over the past year was wholly in securities other than United States Government issues, the holdings of the latter having shown a slight increase.

A Reversal of Trend

Since June there has been evidence in the figures of the weekly reporting banks of a reversal of the panic trend. For these banks, the low point of the year in outstanding credit was touched in the third week of July. Since then there has been an increase of $600,000,000 in total loans and investments and nearly $1,320,000,000 of total deposits. Gold and currency are flowing back into the banks, and bank reserves are back to pre-panic levels. This improvement in the situation, following immediately upon the stoppage of the foreign gold drain and the adjournment of Congress, with accompanying relief from fear of unsound legislation, is impressive evidence of recuperative powers within the economic system, given a period of comparative freedom from disturbing influences.

The degree of recovery that has taken place ought to convince everyone that the restoration of purchasing power does not depend upon radical changes in our monetary system or large issues of paper money. Bank deposits, not paper money, serve as the principal currency of trade, and we have seen that the recent rise of reserves has reestablished the basis for as high a structure of bank credit as had been built up before the panic. But how to put Humpty Dumpty up again is the problem. The failure of excess supplies of funds to reach all sections of the country is one difficulty, and the inability or unwillingness of business to use funds where freely available is another. One thing, however, is clear and that is that neither the gold standard nor the currency supply is at fault. The fundamental trouble is that business itself has not yet been able to readjust itself on a basis permitting a free exchange of goods. And until this is done the large supplies of funds are about as useless as though they did not exist.

The British Situation

The suspension of gold payments by the Bank of England on September 21, 1931, like the act of resumption on April 28, 1925, was more than an act of the Bank, for the Government shared in the responsibility in both instances. The Bank is the national agency for the maintenance of the standard of value and the currency, which obviously are matters of public concern. The action did not signify a deliberate decision to abandon the gold standard for some other monetary system. Somebody has said that Britain slid off the gold basis as a man slides off the roof of a barn when he gets started and cannot stop, which is descriptive but not explanatory. Evidently, the Bank was caught in the grip of circumstances which made the step seemingly necessary, or the most practical that could be taken. Clearly also, the compelling conditions were due to the war and the derangements of world affairs resulting from the war. More than a year has elapsed since the suspension, and as it was an event of worldwide concern, it may be of interest to review the circumstances briefly and also the experience of Britain with a more or less "managed" currency.

Britain's Pre-War Position

For many years preceding the war the position of Britain upon the gold basis and in world trade and finance had appeared to be absolutely secure. Although she was not as preeminent in world trade as once she had been, this was rather because vigorous competitors, notably the United States and Germany, were coming into a larger share of an increasing aggregate trade, than because Britain was fail-

All Member Banks—Classification of Loans and Investments
(In Million Dollars)

			Loans To Other Customers				Open-Market Loans			Investments		
June 30	Total Loans & Investments	Loans to Banks	Total	Secured By Stocks & Bonds	Secured By Real Estate	Other Secured & Unsecured	Total	Purchased Paper	Loans to N. Y. Brokers	Total	U. S. Gov. Securities	Other Securities
1929	35,711	670	22,517	7,734	3,164	11,618	2,472	447	2,025	10,052	4,155	5,898
1930	35.656	535	21,565	8,061	3,155	10,349	3,113	748	2,365	10,442	4,061	6,380
1931	33,923	457	19,257	7,117	3,216	8,922	2,103	886	1,217	12,106	5,343	6,763
1932	28,001	573	15,267	5,292	2,894	7,081	747	469	278	11,414	5,628	5,786

ing to make satisfactory progress. She still led in exports, and far outranked her rivals in income of the "invisible" class, i. e., in the form of interest and dividends from foreign investments and as compensation for shipping, banking, underwriting and other expert services. This income buttressed her position upon the gold standard with great strength, enabling the Bank to safely handle a great volume of international exchanges with comparatively small gold reserves. Indeed it seemed to make the Bank's position impregnable.

The war did not seriously affect the amount of British foreign capital holdings, although they were not increased as otherwise doubtless would have been the case. An important part of the American holdings were sold in this market, but by no means all. Other British investments abroad were generally of a class not readily realizable outside of the British market. Since the war an important body of new foreign investments has been made, including those in the Dominions, and it may be that the total of such holdings is now as large, nominally, as before the war. However, serious losses must have been suffered in Russia, China and elsewhere, and the low prices ruling for the products of debtor countries, with the resulting difficulties in the money exchanges, inevitably have reduced receipts of current income.

Loss of Trade

British export trade has suffered from the development of competition during the war and since, particularly by the rise of Japanese competition in cotton goods, and the increase of cotton goods production in China and India, the latter countries formerly the chief markets of the great Lancashire textile industry. Furthermore, Great Britain, more dependent upon foreign trade than any other nation, necessarily suffered most from the general post-war development of the nationalistic sentiment demanding increased economic self-sufficiency and various measures for the protection of domestic industries.

Finally, however, there is reason to believe that the loss of purchasing power among the producers of primary products everywhere, in part by reason of the falling prices of these products and in part by reason of the high industrial costs established in Britain by the war-time wage-increases, has been the most important of all factors in the loss of British trade and in the country's growing unemployment since 1920. British foreign trade has consisted very largely in an exchange of manufactured goods for foodstuffs and raw materials, and a survey of the price relations between her exports and imports in the year 1930 revealed that the average of prices upon the former was 51.3 per cent above the pre-war level and of the latter only 18 per cent above that level. Obviously, Britain's customers did not possess the buying power to take their accustomed quantities of British goods, and this price disparity between raw and finished goods has increased in the last two years.

Industrial Situation Before and Since the War

In the latter part of 1929 the Chancellor of the Exchequer, the Hon. Philip Snowden, member of the Labor Party government then in power, appointed a committee of fourteen members, all prominent men in business or professional life, "to inquire into banking, finance and credit," and to survey the general business situation and make recommendations. The Committee included bankers, business men and university economists, at least one prominent labor leader, and was headed by Lord Macmillan, an eminent jurist. Its report, known as the Macmillan Report, was submitted in June 1931 and has received much attention. It contains authentic information concerning British industry, trade and financial affairs. The following extracts indicate the Committee views of the industrial and trade position of the country in the years preceding the war and up to 1929:

> Before the War we managed to combine, with a standard of living higher than that of almost any other country in the world, a flourishing and growing export trade. Although our costs were higher than in most other countries, we were still able to compete, though under a growing pressure from our rivals. We owed this favourable position to the advantage of being the first in the field, of having long had an established position, and of the world evincing a keen demand for our special products. Moreover, we were assisted greatly by the vast sums we lent abroad which were used by the borrowers largely in making purchases in this country.
>
> In 1929 our exports of manufactured goods, though declining, were still greater than those of any other country in the world. At the same time our real wages, whilst comparing unfavourably with those in the United States (which country, however, is unable to compete with us in world markets in our principal staple exports such as coal or textiles and many iron and steel products) were much higher than those paid by any of our chief European competitors, as shown in the following table (for January, 1930) based on hourly time-rates of wages:—

Great Britain	100
Holland	87
Germany	77
France	58
Italy	43

> If we could retain so substantial an export trade in spite of so great a disparity of wage-rates, it would seem unlikely that our technical efficiency can have been much inferior to that of our competitors.

The Wage Question

As appears from the above, wages before the war were substantially higher in Britain than in the continental countries, and the differences have been increased by changes in the currencies. The currencies of Belgium, France, Italy and the countries of Central Europe were much depreciated during the war and were finally established again on a gold basis at depreciated values. The effect

was to accomplish for the time being at least, a reduction of real wages in those countries. On the other hand, Great Britain, unwilling to lower the gold value of the pound sterling, resumed gold payments in 1925 at the pre-war gold par. Logically this seemed the course that would best serve the national interests as a creditor country and a country with a great world trade. It lowered the cost of raw materials for her industries and the cost of living as affected by imported food, but by increasing real wages increased manufacturing costs and resulting prices.

The report states that from the period 1924 to 1929 the general level of wages was from 170 to 175 per cent of the pre-war level, and that they had since fallen but slightly. However, the fall of commodity prices had lowered the cost of living, with the result that in 1929 real wages (purchasing power) were 8½ per cent above the level of 1924. In April 1931 the same influence, continuing, had raised real wages to 20 per cent above the 1924 level. These calculations are based on regular wage rates, taking no account of overtime, short time or unemployment. There was much unemployment even in the period 1924-29 and it increased to the last date named, as a result of declining trade.

It is noteworthy that notwithstanding the decline of living costs reported by the Committee, such costs as officially reported on October 1, 1932 were still 43 per cent above the pre-war level. Thus in Britain, as in the United States, high nominal wages are maintaining living costs at an abnormal level while lack of employment is causing actual wage-earnings to be abnormally low, and the wage-workers as a body are anything but prosperous.

The firm maintenance of wage rates while prices of the products and costs of living were falling may have been good for the workers who were able to retain full employment, but it reduced the purchases of foreign customers whose own products were falling, thus diminishing sales and causing thousands of British workmen to lose employment. It has given a convincing demonstration of the importance of balanced relations.

Effects on Finance

The decline of exports also had the effect of increasing the trade balance against Britain in the foreign exchanges, and as income from foreign investments was likewise declining the balance of payments on all accounts became adverse, thus reversing the country's long-time position, and causing a drain on the gold reserves. London has long been the chief banking center of the world, with large sums of foreign deposits held by her banks. Furthermore, as world banker, London has been accustomed to lend freely when called upon by her foreign customers, and did so when the financial crisis developed throughout Central Europe in the Spring of 1931. Gold withdrawals became heavy, the bank panic in Germany in July accentuated the alarm, and the combination of circumstances was so formidable that the suspension resulted.

British Opinions Upon the Crisis

Among the findings of the Macmillan Committee is embodied the significant statement that whereas since 1913 the volume of imports of Great Britain has increased 18 per cent, the volume of exports of domestic products has decreased no less than 32 per cent. The report was published several months before the suspension occurred, but it sums up in a rather lengthy sentence a description of the most important conditions accounting for the suspension. Presumably the language was acceptable to all the members, and is as follows:

> We must, therefore, attribute the difficulties of those of our industries which are either substantially dependent on exports or which are exposed to the competition of foreign imports, largely to the fact that sterling costs did not prove adjustable to the change in the value of sterling necessary as a consequence of the return to gold at the pre-war parity; and still more so to the heavy fall in world prices which has since occurred.

The "heavy fall in world prices" alluded to affected the primary products which comprised British imports much more than British products, owing to the rigidity of British manufacturing costs. The gap between import and export values was thus widened. Superficially it might seem to be an advantage to Great Britain to be selling at high prices and buying at low prices, but British trade melted away.

Three months before the suspension occurred, in its issue of May 23, 1931, the London Statist, a long-established and highly regarded journal devoted to finance and economics, in a lengthy editorial, described in plain terms the conditions that were developing and the threatening effects of the existing disequilibrium in industry and trade, saying in part:

> The forces of inertia in this country, which have caused this successful resistance against the influences making for equilibrium, are a commonplace of recent discussions of our own economic crisis. Trade union regulations, rigidity of wages, and rigidity of minds, have deprived our economic system of any claim which it may once have had to real elasticity. And yet, though the problem presented itself to this country in a more severe form than to any of our competitors, and though there are traits in our economic make-up which rendered it far more difficult to overcome than a similar problem would be to a more elastic nation, its solution is the sine qua non of our economic survival. Dependent as we are upon our foreign trade, our economic existence must be based upon an ability to produce and distribute goods at a price at which they can meet competition in the world markets.

The London Bankers Magazine for October, 1932, in an editorial article reviewing the year that had passed since the suspension and re-

ferring to the conflicting opinions about the policy of returning to the pre-war gold par in 1925, says:

As to the question of our having returned to the gold standard prematurely in 1925, it is now quite clear that it was not so much a case of our returning prematurely, but of failing to conduct a policy in harmony with our re-assumption of gold responsibilities. Not by any means for the first time, the Government, while acting on sound lines with regard to currency policy, failed completely to act in similar fashion with regard to questions affecting wages and conditions of working. It was, in fact, essential that if we were to remain on gold, costs of production should be reduced, and this was rendered impossible in many of the basic industries by reason of the rigidity of wages and of other matters such as hours, conditions of working, etc., all affecting production costs. It seems necessary to recall the fact and to insist upon its importance because, whatever may be our policy in days to come with regard to monetary and currency affairs, it will always be true that, whatever is done in the way of devaluation or of new methods, we must, as a great importing country of the necessities of life, be able to produce an adequate volume of goods and services to exchange for the necessary imports received.

Managing the Currency

The suspension of gold payments last year was accepted, as a rule, with regret by the financial community, which viewed with misgivings the loss of a definite basis of exchange relations with other monetary systems and of price relations in international trade. It did not welcome an experiment with a "managed" currency, which the public would be constantly watching as a sick person watches his temperature, and which probably would be the subject of endless agitation. On the other hand, the industrial, and particularly the exporting, interests welcomed it, as reversing the action of 1925, which had amounted practically to imposing a wage increase upon them, and as possibly enabling them to quote lower prices upon goods and recover some trade.

The effects of the change as seen during the year have not been very pronounced as respects either prices or business, although the currency has had pronounced fluctuations from gold, ranging from about 20 to 33 per cent below the gold par. That the fluctuations have not had greater effects has been due in the main to the fact that the general trend of gold prices was downward, while the influence of currency depreciation was to carry domestic prices upward, the one influence thus offsetting the other. The London Economist price index, based on 1927 as 100, shows the figure 60.4 for September 18, 1931 just before the suspension, and 60 for November 2, 1932. The effect of currency depreciation was lessened not only by the fall of gold prices but by the fact that an important share of British imports come from countries whose currencies have been depreciated as much as or more than British currency, as in the case of Australia, Argentina, the Scandinavian countries, etc. Goods of internal production have not been much affected.

The first drop of the currency stimulated quite a volume of new foreign orders, but the gain has not been maintained. For the ten months ended with October, 1932, total exports of British-made goods aggregated £301,547,000, against £325,223,000 in the corresponding months of 1931, and £488,037,000 in the corresponding months of 1930. The 1932 figures do not reflect the full decline in physical volume, because the valuation is in a currency depreciated on the average 25 per cent or more. The pressure upon wages has increased and within the last two months both the spinning and weaving branches of the highly organized cotton goods industry, including approximately 400,000 operatives, have accepted a general reduction of 1 shilling 6½ pence in the pound, or about 7.8 per cent. This was a compromise after long negotiations. The railroads secured a wage reduction of about 4½ per cent last year and are now moving to make it full 10 per cent. Present rail wage rates are represented by the companies to average about 100 per cent above the pre-war rates.

Fluctuations of the Currency

The value of the pound sterling in United States currency dropped rapidly after the suspension from the par of $4.866 to the low point, of $3.25 on December, 1931. From there it worked gradually up to about $3.45 in Jan. and Feb., 1932, then shot up to $3.80. This movement was believed to be against the wishes of the Treasury, which is thought to have promoted a decline to about $3.46, where it seemed for a time to be pegged by the Treasury. Suddenly in the last half of October it dropped to about $3.27, recovered to $3.33, and then slumped again. Since then it has been influenced by the reports regarding the debt payment to the United States and fallen as low as $3.14¾ on November 29th.

These are fluctuations in comparison with the currencies of the gold standard countries, and the British newspapers with loyalty to their own, are inclined to refer to them as occurring on the gold side. The one thing upon which there is agreement is that they are a costly annoyance to all trade between Britain and the gold standard countries, and of course both sides are interested in the trade. There can be no question that Britain, with her great interest in international trade has a greater concern than any other country in the maintenance of a common standard of value for all countries.

There is no end to the argument over the question whether a country can profit by the depreciation of its own currency, but there is agreement that in order to have a continuing profit the currency must continue to depreciate, and that the profit-making ends when

the currency becomes worthless. It is therefore a game of limited and uncertain duration, and, unless the currency is always moving in one direction and at a uniform rate (which never was known) its vagaries are past calculation. The most ruinous form of competition the nations could engage in is competition in depreciating the value of their money. It repeats for all of them the experience of Germany from 1919 to 1923.

Parliament provided the Treasury with a fund of £150,000,000 (about $500,000,000) with which to control or "stabilize" the sterling exchanges, which is presumed to mean to protect sterling against manipulation and shape its general course. The course in the last year has been marked by some eccentric movements, which has indicated that it was now under control and then left to itself.

The rapid fall from $3.46 to under $3.30 occasioned much speculation as to the cause or purpose, but the most reasonable explanation seems to be that the fall was due to a weight of payments out of sterling into gold currencies, which the Government did not choose to facilitate by the depletion of its exchange fund. Fall is the season of the year when imports usually are heavy, and there has been a substantial amount (about £165,000,000) of the old 5 per cent debt which has not been converted into the new 3½s. Much of this is supposed to have been held by foreigners who, in view of the low interest rates ruling in London, may want to convert into other currencies.

The Prospect for the Pound Sterling

The success of the great refunding operation and the prospect that, with the aid of the new import duties, the budget will have a surplus this year, are two developments which make the situation much better than it was a year ago, but no authority yet ventures to predict the future course of exchange relations between British and foreign currencies. It is practically agreed by the three British authorities quoted above that the country was forced off the gold basis by the effects of its high industrial costs upon its volume of exports. One way or another exports must be increased or imports reduced in order to find an equilibrium in the country's international payments and stabilize the exchanges. The depreciation of a currency tends to lower real wages without affecting nominal wages, and was expected to aid exports, but the effects were obscured by the continuing fall of gold prices. It remains to be seen whether the recent weakness in sterling has been due to temporary causes, such as seasonal trade, shifts of capital, prospective debt payment to the United States, etc., or to a continuing disequilibrium in trade and the more constant items of income and outgo. There is no expectation that the pound sterling will be restored to its former gold par.

There is no escape from the conclusion stated by the Bankers' Magazine as quoted above, that a country which must import heavily in order to live must export equal values in payment, or its supplies will be shut off. No inflation or depreciation of the British currency can alter the trade situation except as it may reduce production costs and so increase exports. Some of the British labor leaders have been quick to apprehend the effect of currency depreciation upon the purchasing power of wages, and have opposed the policy, but the argument is rather too abstruse to be made the basis of a militant stand for wage increases unless an important rise of living costs occurs. At present the unions are short of funds to support strikes.

There can be no question that a general revival of trade and recovery of prices, whenever it comes, will work an important change in the British situation. It will increase consumption, clear away stocks, tend to relieve the pressure of competition and in particular lessen the emphasis upon low prices at the expense of quality. British manufactures are largely of the quality class, and have suffered on this account. In the cotton goods industry the unemployment and loss of trade has been mainly in the cheap grades, the mills running upon Egyptian long-staple cotton in the production of fine goods having held their business very well.

The situation is clearly due primarily to the derangements in industry and trade resulting from the war, and specifically to the failure of wages, which had been advanced in war time in correspondence with the increase in living costs, to decline in correspondence with the fall of prices and living costs. After all, the British situation in regard to foreign trade appears not very different from that of the United States in its domestic trade. We have not the same need to import food and raw materials, but the same confusion exists over the terms of exchange between raw and finished products, and this is the principal cause of the depression in both instances. The whole world is getting a practical lesson in trade relations. There is no real occasion for controversy, for the standard of living is not involved. The standard of living is not in nominal wage rates, but in the products that enter into consumption, and the quantity of these available depends upon the efficiency of industry and fair trade relations between the various groups of producers.

Criticism of the Economic System

The British Association for the Advancement of Science is an organization of like character to our own of similar name, but

much older, indeed the best known society of the kind in the world. The annual meeting, held in September last, was presided over by a distinguished engineer, Sir Alfred Ewing, whose age (seventy-seven) and position in his profession give assurance of his competence to discuss the period of mechanical development through which he has lived. In his presidential address he expressed himself as disillusioned by "the sweeping pageant of discovery and invention" in which he "used to take unbounded delight." The gains in the productive capacity "which had seemed to promise so much for the comfort and happiness of humanity, although successful beyond all possible dreams in increasing the command of man over the natural resources, had not been successful in producing happiness or even in affording a guaranty of comfort and security." He said in part:

The pageant itself is a modern affair. A century ago it had barely taken form and had acquired none of the momentum which rather awes us today. The industrial revolution, as everybody knows, was of British origin; for a time our island remained the factory of the world. But soon, as was inevitable, the change of habit spread and now every country, even China, is becoming more or less mechanical.

The cornucopia of the engineer has been shaken over all the earth, scattering everywhere an endowment of previously unpossessed and unimagined capacities and powers. Beyond question many of these gifts are benefits to man, making life fuller, wider, healthier, richer in comforts and interests and in such happiness as material things can promote.

But we are acutely aware that the engineer's gifts have been and may be grievously abused. In some there is potential tragedy as well as present burden. Man was ethically unprepared for so great a bounty. In the slow evolution of morals he is still unfit for the tremendous responsibility it entails. The command of nature has been put into his hands before he knows how to command himself.

There is no room for controversy over his statement that the benefits derived from industrial development in the last century have made life "fuller, wider, healthier, richer in comforts and interests and in such happiness as material things can promote." It has shortened the hours and improved the conditions of labor, substituted machine power for much of the most toilsome labor formerly done by human hands, made possible the education of the masses and by cheapening the printed page opened for the masses the door to knowledge and power. It has financed the science of biology, with all its services to human welfare in hygiene, surgery and the control of disease, provided the facilities of communication and transportation which have rendered possible the utilization of the most remote resources of the earth, enormously increased the productivity of labor, and accomplished a broad distribution of the results, as seen by the fact that an overwhelming proportion of the industrial product enters into common consumption.

Furthermore, it has done this for an increasing population. To estimate the service of modern industry with its capital equipment to the masses it is necessary to think of what living conditions would be for the present population of the world if the means of production and transportation were no better than they were a century ago. It is estimated that the population of Europe grew from 180,000,000 in 1800 to 460,000,000 in 1914. It had this growth, in comparison with the growth to 180,000,000 in all preceding time, because of more favorable living conditions. Moreover, this growth of population was despite the fact that since 1800 Europe has sent millions of her people to populate the new countries of the world.

Ethical Deficiencies

No doubt there is ground for the opinion advanced by the speaker that mankind was not ethically prepared to make the most of this great advance in material welfare, and that moral development has not kept pace therewith. This is not saying that morals have deteriorated, or that industrial progress has retarded ethical development, although Sir Alfred believes that the workman has lost something of "the joy of craftsmanship, the old satisfaction in something accomplished through the conscientious exercise of care and skill." This prompts a question as to the value for culture of increasing leisure, and also the one suggested above as to the value of industrial progress to an increasing world population, and finally the consideration that as common necessaries are more cheaply supplied there will be a greater demand for skilled craftsmanship than ever in the past.

Lack of Understanding

Doubtless in speaking of ethical and moral deficiencies Sir Alfred had broadly in mind those which affect the ability of people to live in amicable and mutually-helpful relations in organized society. Emerson said that the real test of civilization was in "facility of association," meaning the ability of people to understand each other, get along together and work together for common interests. Ethical and moral deficiencies, as they are revealed in such emotions or defects as suspicion, prejudice, vanity, envy, greed, intemperance, hatred, and other familiar traits of human nature, make trouble in every organized social effort—the economic organization and political government included—and probably will do so in any reorganization of the present organizations until human nature is free from them.

It is probable that the chief cause of failure in efforts at cooperation is in "lack of understanding." Probably Emerson's thought is essentially the same as that of the wise old prophet who said, "with all thy getting get understanding." In view of the rapid development of the modern economic system as de-

scribed by Sir Alfred Ewing it seems that he might have accounted at least in part for the shortcomings he deplores as due to a general lack of understanding of the system—of how it works, what it accomplishes, and the relations between the factors composing it. It is a complicated system because of its great variety of services, and not many people take the trouble to understand the principles of economic law by which it is governed when not interfered with by forces outside of itself, as by war.

The utterances of the critics usually express skepticism or contempt of economic law, but there is a body of learning and defined principles regarding economic life, which is the result of study and experience. There is a technology of the economic system, as there is of each separate branch, and a knowledge of it is necessary to intelligent and orderly cooperation. There is no conflict between economic law and the moral law, or between economic principles and the ideals of ethics and religion, as there is none between these ideals and the technical knowledge which is required to manage a railroad system, build the George Washington bridge or plan a monetary and banking system. The well-meaning people who in more or less casual bodies pass resolutions denouncing the economic system for the existing unemployment would direct their efforts to better purpose, if they concentrated upon the evident truth that War is ruin to the modern economic system and the cause of the present situation.

Development of the Economic System

Organized society has been a continuing experiment in cooperation from the beginning. Primitive society had little need for cooperation. The population spread out over the land and obtained subsistence direct from the resources of nature. Gradually the simple industries were developed and the people learned the advantages of trade. As skill, science, specialized knowledge and capital became increasing factors in production there developed the vast and complicated system of industry and trade known in modern life.

In effect it is a system of voluntary and almost unconscious cooperation, based upon the principle of an exchange of services, although accomplished by the use of money. A great stimulus to industrial development has come through the endless possibilities of this system of exchange, under which the buying power of every member of the system exists in what he is able to offer in the markets. There is no limit upon the volume of production and trade, within the range of human wants, so long as production is approximately balanced between the different commodities and services. The maintenance of the balance in price relations is also necessary, but this naturally results from balanced production.

General Overproduction Inconceivable

Ever since steam-power and machinery began to increase the supplies of commodities and raise the standard of living, alarms have been sounded from time to time that overproduction and permanent unemployment were impending, but the alarms never have been verified, for wants never yet have been satisfied. The development of installment selling on a great scale and the provision of large facilities for supplying "consumer's credit," are tangible proof that up to a very recent time the wants of the people were growing faster than they could be supplied.

There have been periods of reaction and unemployment resulting from derangements of the economic system which interrupted the flow of goods into consumption, but such conditions do not signify over-production in the sense that a surplus has been created above wants.

Sensational reports of impending developments in industry are again appearing, but there will have to be more tangible evidence in the markets before they need be regarded as anything but words of encouragement for the future. The great and pressing need of the present time is a lowering of the costs of production, particularly in all lines in which they are still above the 1913 level. Notwithstanding the low prices of farm products and raw materials the cost of living, as reported by the United States Bureau of Labor, is still more than 35 per cent above the 1913 level. Apparently the high costs are in fabrication, construction and transportation. A lessening of the gap between primary products and finished goods, which is the main cause of present economic conditions, will be of great benefit.

Obviously the economic system is a complex and interdependent organization, composed of many independent factors, whose harmonious cooperation is required. These conditions contain the possibilities of disorder. Since the system is based upon the exchanges, there must be reasonable stability in relationships or trade will not flow freely, goods will pile up, prices will fall, industry will slow down and unemployment will result. Any derangement of the normal equilibrium in production and trade will have these effects. Ordinarily, the system is regulated successfully by the natural play of economic forces, but at times it is put seriously out of balance either by maladjustments within itself or disturbances from outside.

The development of money as a standard of value and medium of exchange has been nec-

essary to the vast system of trade, but the relations between the different groups of the population and their dependence upon each other is obscured by the very efficiency of the money service. Each group is prone to think of its own compensation in terms of money, rather than in terms of exchange relations, although the latter are of chief importance.

Both money and credit are indispensable factors in modern business, but there has been much disagreement about the management of both. The problem of controlling the use of credit in a period of expansion admittedly has not been fully mastered, and that of maintaining the supply of credit in a period of public alarm is one of equal difficulty. Both are problems in economics which governments have taken in charge, but have not thus far handled with entire success.

Effects of the War

The most serious disturbances from which the economic system ever has suffered have originated outside of the system itself, either from defects in the banking and currency systems established by the political authority, or from War. Wildcat banking was principally responsible for a number of panics in our early history, an inadequate banking system was principally responsible for the panics of 1893 and 1907, and the fact that this country has had 8,000 bank failures since 1925 while Canada has had none, is evidence that a faulty banking system has contributed to our present troubles. The two worst depressions this country ever has known, the present one and that of 1873-1879, have been directly related to wars. Since the last war was the greatest ever known and the world economic system was at the height of its development, the extent and violence of its effects were far beyond anything experienced before.

Certain industries, notably agriculture outside of Europe, were stimulated to an expansion which afterward was the leading factor in the fall of prices. The unlimited demand for man-power, together with the rise of living costs, resulted in the doubling of wages, an unprecedented and abnormal change which eventually became the chief factor in the great unemployment. The credit inflation involved the world in a burden of indebtedness from which it does not yet know how to find relief. Reparations and war debts are highly disturbing factors in international relations. The extraordinary movements of gold, set in motion by war conditions, have compelled the abandonment of the gold standard by the greater part of the world, and perhaps deprived the world of the benefits of an international standard of value for an indefinite time.

It is sometimes asked why the alleged effects of these influences did not appear until more than ten years after the war was ended. A serious reaction occurred in 1920-21, and farm products have been below their pre-war parity with other products ever since, but they recovered in part, and various conditions resulting from the war combined to sustain the other industries. A dammed up volume of construction and development work and other expenditures was released, giving a great impetus to industry. In the devastated regions of Europe vast rebuilding operations were under way for years. In Europe the depreciation of the paper currencies, and in this country the importations of gold produced speculative conditions which induced the creation of private indebtedness and gave a fictitious appearance of great prosperity. Expenditures, both public and private, were stimulated by the delusions of the time, and fostered them. Thus the reaction from the restrictions of the war time, plus an abundant supply of credit, led to the excesses of the boom period, which ended inevitably in the collapse of credit and prices, shrinkage of values, a violent swing from free expenditure to drastic economy, with general business disorganization, unemployment and the vicious circle.

The results of the war-time expansion of agriculture outside of Europe were not realized until Russia and the countries of the Danube Basin resumed their exports of foodstuffs, the interruption of which had caused the war-time rise of prices. This resumption did not occur in volume until the crop year 1929-30. World production had been adjusted to the disappearance of these countries as exporters, and their reappearance disturbed the new equilibrium, created burdensome stocks of wheat in the markets, and broke the prices not only of wheat but other agricultural products. The uncertainty regarding Russian exports in the future, together with actions by governments of producing countries to sustain prices and by importing countries to restrict imports, had the effect of discouraging the legitimate speculation which is always necessary for the support of prices in the face of accumulating supplies. The result was extreme demoralization in prices of the staple agricultural products over the world. At the same time the prices of plantation products and other primary products, many of which had been sustained by artificial means, gave way in a general debacle, and all of this coincided with the break in security and property values referred to above.